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DALLAS
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NEW YORK

1722 EYE STREET, N.W.
WASHINGTON, D.C. 20006
TELEPHONE 202 736 8000
FACSIMILE 202 736 8711

FOUNDED 1866

HONG KONG
LONDON
SHANGHAI
SINGAPORE
TOKYO

WRITER'S DIRECT NUMBER
(202) 736-8198

WRITER'S E-MAIL ADDRESS
thynes@sidley.com

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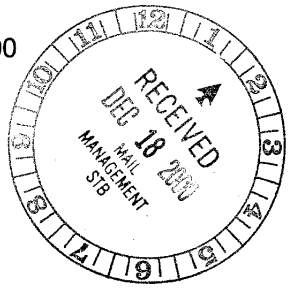

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
Case Control Unit
1925 K Street, N.W.
Washington, D.C. 20423-0001

Re: STB Ex Parte No. 582 (Sub-No. 1); Major Rail Consolidation Procedures

Dear Mr. Williams:

Enclosed for filing in the above-captioned proceeding are the original and twenty-five (25) copies of Canadian Pacific Railway Company's Reply Comments (CPR-5). Also enclosed is a computer disk containing a copy of this submission in WordPerfect format.

Please date-stamp the two (2) extra copies of the enclosed filing and return them via our messenger.

Sincerely,

Terence M. Hynes

Enclosures

cc: All Parties of Record

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CPR-5

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB EX PARTE NO. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

REPLY COMMENTS OF CANADIAN PACIFIC RAILWAY COMPANY REGARDING PROPOSED RAIL CONSOLIDATION REGULATIONS

Marcella M. Szel Q.C.
Canadian Pacific Railway Company
Suite 500, Gulf Canada Square
401 – 9th Avenue, SW
Calgary, AB T2P 4Z4
(403) 319-7000

Terence M. Hynes
Sidley & Austin
1722 Eye Street, N.W.
Washington, D.C. 20006
(202) 736-8000
(202) 736-8711 (fax)

Timothy G. Mulcahy
Canadian Pacific Railway Company
Suite 1000, Soo Line Building
105 South Fifth Street
Minneapolis, MN 55402
(612) 347-8325

Counsel for Canadian Pacific Railway Company

DATED: December 18, 2000

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB EX PARTE NO. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

REPLY COMMENTS OF CANADIAN PACIFIC RAILWAY COMPANY REGARDING PROPOSED RAIL CONSOLIDATION REGULATIONS

Pursuant to the Board's October 3, 2000 Notice of Proposed Rulemaking in the above-captioned proceeding (the *"NPR Order"*), Canadian Pacific Railway Company and its wholly-owned subsidiaries, Soo Line Railroad Company ("Soo"), Delaware and Hudson Railway Company, Inc. ("DHRC"), and St. Lawrence and Hudson Railway Company Limited ("St.L&H") (collectively "CPR") submit these reply comments concerning proposed modifications to the Board's Railroad Consolidation Procedures (49 C.F.R. §§ 1180.0–1180.9).

A common theme in the initial comments submitted by non-carrier parties is that the proposed merger regulations are "too vague" and fail to impose specific obligations upon future applicants to enhance rail competition and guarantee post-merger service quality.[1] Indeed, certain commenters complain that the proposed regulations would give the STB "unfettered

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[1] *See, e.g.*, Comments of Dow Chemical Co. ("Dow") at 3-4; DuPont at 3; National Industrial Transportation League ("NITL") at 3; The Fertilizer Institute/Canadian Fertilizer Institute at 3, 6-8; American Forest Resource Council at 2; PPL Generation LLC at 7-12; Proctor & Gamble Co. at 1.

discretion" to balance the public benefits of future rail consolidations with the need to preserve or enhance rail-to-rail competition.[2] In order to remedy this perceived shortcoming, shippers urge the Board to adopt a variety of "pro forma" requirements and conditions that would compel all future merger applicants to supplement the competitive choices of shippers, and would impose substantial financial penalties for post-merger service failures.

The Board should reject such a cookie-cutter approach to merger review. The STB's adjudicatory decisions must be based upon the evidence presented in each proceeding.[3] The merger statute – by design – delegates to the STB broad discretion to fashion conditions as necessary to mitigate public interest harms that might otherwise result from a particular consolidation. *See* 49 U.S.C. §§ 11323 *et seq*. A case-by-case approach to competition and service issues is fully consistent with the Board's statutory mandate. CPR urges the Board to adopt regulations that provide flexibility to deal with merger-related competition and service issues as they arise, without prejudging the effects of particular transactions.

I. GENERAL/PROCEDURAL ISSUES

Several parties urge the STB to adopt a "rebuttable presumption" that further consolidation among Class I rail carriers would not be consistent with the public interest.[4] In

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[2] *See* Comments of Martin Marietta Materials, Inc. at 4. *See also* Comments of Edison Electric Institute ("EEI") at 5; Montana Wheat & Barley Comm. at 3; Enterprise Products Operating LP at 5.

[3] *See* Comments of CPR (filed November 17, 2000) at 10-11.

[4] *See, e.g.*, Comments of BASF Corp. at 14-15; Weyerhaeuser Co. at 4; Williams Energy Services at 3.

particular, they suggest that, in reviewing future mergers, the Board should proceed from the assumption that "all Class I mergers are anticompetitive."[5] As CPR has previously shown, such a sweeping presumption would be contrary to well-established principles of administrative law. *See* Comments of CPR at 10-11. The proponents of this presumption fail to explain how ***all*** prospective Class I combinations – most of which are likely to be end-to-end in nature – would, on balance, be harmful to the public interest.[6] The Board should, of course, carefully evaluate the competitive effects of future Class I rail mergers and impose conditions as necessary to mitigate any adverse impacts caused by such transactions. However, the Board's regulations should not assume that all mergers would have anticompetitive effects or would otherwise be inimical to the public interest.

A number of commenters support a requirement that all future mergers be implemented in stages under STB supervision.[7] USDOT argues that such a mandatory phase-in "would result in a controlled step-by-step integration process." Comments of USDOT at 11. BASF and Williams Energy Services go even further, advocating a "complete recodification" of 49 C.F.R. § 1180 to provide for a new three-step merger review process.[8] These proposals

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[5] Submission of Weyerhaeuser Co. at 4.

[6] USDOT cautions that it is "premature" for the Board to assume that all future mergers will generate competitive problems, and urges the Board to analyze the competitive effects of mergers, and the necessity for conditions, on the basis of the record evidence in each case. Comments of USDOT at 4.

[7] *See, e.g.*, Comments of USDOT at 11-12; City of Mankato, MN at 4-5.

[8] *See* Comments of BASF at 15-16, 28-30; Williams Energy Services at 3-4. Under these proposals, the application process would be divided into three stages. In the first stage,

(continued...)

should be rejected. The BASF/Williams proposal would simply expand the number of regulatory steps required to obtain merger approval, without enhancing the ability of the Board and the public to gauge the impacts of future transactions. Adoption of such a procedure could threaten the Board's ability to complete its review of proposed mergers within the statutory timetable prescribed by 49 U.S.C. § 11325. Moreover, regulatory micromanagement of the post-merger implementation process is neither necessary nor desirable. The STB should carefully scrutinize applicants' Operating Plan and Service Assurance Plan, in order to satisfy itself that applicants' implementation plans are workable. As part of the oversight process, the Board should require applicants to report periodically on their progress in integrating their respective systems. However, the Board should ***not*** require the merging carriers to obtain additional STB authorizations to undertake the successive steps of the integration process, nor should the Board otherwise interject itself in the day-to-day management of the merged carrier.

The Committee To Improve Coal Transportation ("IMPACT") proposes a rule that would require a "cooling off" period of at least three years between major consolidation transactions. Under IMPACT's proposal, upon the filing of a merger application by two Class I railroads, the remaining carriers would be required either to submit their own follow-on mergers to the STB as "responsive" applications in the initial merger proceeding, or wait for 36 months

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(...continued)
("Corporate Merger"), applicants would be required to demonstrate that they could make a *prima facie* case for approval, as a prelude to consummating the underlying corporate transaction. The second phase ("Business Merger") would entail a more searching STB review of the proposed merger. The final phase ("Operational Merger") would require applicants to demonstrate their preparedness to integrate their rail systems.

after "implementation" of the first merger before being permitted to seek authorization for the follow-on transaction. Comments of IMPACT at 19-21. Such a rule would place enormous pressure on the remaining carriers to reach agreement with a merger partner within weeks of the announcement of an initial Class I merger, in order to avoid being "left behind" by their competitors. The alternative – a three-year prohibition on pursuing a responsive merger – would confer an unacceptable marketplace advantage on the parties to the initial merger.[9] If IMPACT's suggestion is adopted, the next Class I merger proposal will, in all likelihood, precipitate a stampede of responsive mergers – the very result that shippers say they are concerned about.[10]

II. ALLIANCES

Several commenters ask the Board not only to raise the bar for approval of rail consolidations, but also to erect new regulatory barriers to marketing alliances and other strategic arrangements short of formal merger.[11] These parties express concern that railroads may elect to "bypass" the merger process by pursuing alternative arrangements (comments of ORDC at 16), and that such a course would "preclude shippers from realizing the benefits [of] enhanced

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[9] Indeed, the "cooling off" period proposed by IMPACT could disrupt the competitive equilibrium of the rail industry, by giving those carriers that chose to merge first a three-year "head start" on their competitors. Such a competitive advantage could produce effects harmful to the public interest.

[10] The pressure to merge created by IMPACT's proposal could lead carriers to forego alternative strategies, such as marketing alliances or similar joint ventures, that hold the potential for generating significant public benefits without the downside risks of a formal consolidation.

[11] *See, e.g.,* Comments of NITL at 27-30; Dow at 21-22; DuPont at 7-8; American Chemistry Council ("ACC") at 11-12; Ohio Rail Development Commission ("ORDC") at 16.

competition, as proposed in the new merger rules." Comments of Dow at 20.[12] They suggest that, in the absence of STB regulation, cooperative agreements among unaffiliated railroads might escape competitive scrutiny altogether.[13] Their solution to this supposed regulatory gap is for the STB to assert jurisdiction to review "most non-merger cooperative agreements." Comments of Dow at 20.[14]

The STB should reject such calls to regulate voluntary carrier initiatives short of merger.[15] The Board's statutory jurisdiction is limited to those transactions which involve the merger or control of two carriers (49 U.S.C. §§ 11323-11325) or the pooling of traffic, services or revenues (49 U.S.C. § 11322). Marketing alliances and similar cooperative arrangements that

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[12] It appears that the objective of these commenters in seeking formal regulation of carrier alliances is to subject those arrangements to the same "enhanced competition" requirement that the STB proposes to apply to merger transactions under the draft regulations.

[13] *See* Comments of Dow at 21; NITL at 30.

[14] The commenters express divergent views regarding the standards that the STB ought to employ in scrutinizing railroad alliance agreements. The American Chemistry Council proposes that the Board review such agreements using the Antitrust Guidelines for Collaborations Among Competitors recently adopted by USDOJ and the FTC. *See* Comments of ACC at 11. Other parties contend that those guidelines are "not well-suited to addressing the anticompetitive effects of railroad combinations," and suggest instead that the Board apply the standards set forth in the proposed merger regulations to alliance arrangements. *See, e.g.*, Comments of Dow at 21-22; NITL at 29.

[15] Even if the STB were inclined to establish new rules subjecting marketing alliances or similar partnering arrangements among rail carriers to greater scrutiny – and it should not – such rules could not be adopted as part of the final regulations published in this rulemaking proceeding. Rather, the Board would have to publish proposed rules governing carrier alliances, and afford interested parties an opportunity to comment on them. *See, e.g., American Water Works Assn. v. EPA*, 40 F.3d 1266, 1274-1275 (D.C. Cir. 1994); *Anne Arundel County v. EPA*, 963 F.2d 412, 417-419 (D.C. Cir. 1992).

do not involve "control" or "pooling" are not subject to prior approval under the ICCTA. The STB cannot expand the scope of its statutory jurisdiction by adopting new regulations to govern alliance agreements.

The concern expressed by certain parties that anticompetitive agreements among unaffiliated railroads might escape scrutiny is misplaced. Absent STB authorization under the control or pooling statutes, alliance agreements do not obtain exemption from the antitrust laws pursuant to 49 U.S.C. § 11321.[16] As the commenting parties acknowledge, both USDOJ and the FTC recently promulgated new antitrust guidelines governing collaborative arrangements among competitors. Those agencies possess ample authority to redress any legitimate anticompetitive effects caused by railroad alliance agreements.

Subjecting joint marketing and interline partnership agreements to burdensome new regulation would be bad policy. The Board's proposed new General Policy Statement explicitly acknowledges that such private sector initiatives hold the potential for substantial public benefits without risking the problems that might accompany another round of major mergers. *See NPR Order* at 12 (proposed § 1180.1(c)). The prospect that such arrangements might be delayed by extended regulatory scrutiny, or even disallowed after a large investment of time and resources has occurred, will lead carriers to forsake creative forms of cooperation and pursue formal mergers instead. If the STB truly wants to encourage railroads to consider

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[16] *See* Finance Docket No. 33556, *Canadian National Ry. Co. et al. – Control – Illinois Central Corp. et al.*, (served May 25, 1999) ("*CN/IC Control*") at 31.

alternatives to merger, it should take measures to ***reduce*** regulatory barriers to innovative strategic initiatives, rather than creating such obstacles.[17]

III. COMPETITION ISSUES

In its initial comments concerning the *NPR Order*, CPR demonstrated that the STB's proposal to require all future applicants to offer measures to "enhance" rail-to-rail competition in their service territory – whether or not the record in a particular case demonstrates that shippers would be harmed by the transaction – is incompatible with both longstanding STB/ICC precedent and fundamental principles of administrative law. *See* Comments of CPR at 2, 8-12. CPR urged the Board to revise its proposed regulations to provide that the effects of a proposed merger, and the necessity for mitigating conditions, will be determined on a case-by-case basis. *Id.*

Shipper commenters propose a radically different approach. They urge the Board to make the regulations more "specific" by imposing a variety of "pro forma" competitive conditions in ***every*** case. The proposed new conditions include (1) various forms of open access

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[17] In its prior comments, CPR urged the Board to articulate a policy that explicitly endorses strategic partnerships among connecting carriers, and to provide a mechanism under which carriers can obtain, on an expedited (and, to the degree permissible under the Board's governing statute, confidential) determination as to whether such transactions require regulatory approval under the carrier control or pooling provisions of the ICCTA. *See* Comments of CPR (filed May 16, 2000) at 6. The Board should consider promulgating such regulations.

or mandatory switching in terminal areas;[18] (2) preservation of all existing gateways;[19] (3) requiring merging carriers to quote rates between any two points where interchange can occur (including rates for "bottleneck" segments);[20] (4) post-merger rate "caps" and/or new forms of rate regulation;[21] and (5) elimination of so-called "paper barriers."[22] These conditions would be imposed on ***all*** applicants in ***all*** cases, regardless of whether the particular transaction would generate unmitigated anticompetitive impacts.

Some shipper parties contend that even these sweeping across-the-board competitive "enhancements" are not enough. NITL is "extremely concerned" that imposing competition-enhancing conditions only on merging railroads (and not on carriers that choose not to merge) would create an "unlevel playing field" for carriers and shippers alike. Comments of NITL at 15.[23] Likewise, Dow suggests that "the Board's insistence upon addressing competition

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[18] *See, e.g.*, Comments of Greater Houston Partnership at 3; Alliance for Rail Competition at 2, 4; PPG Industries, Inc. at 1, 2; Shell Oil Co. at 9-10, 13; Subscribing Coal Shippers at 14-15.

[19] *See, e.g.*, Comments of Greater Houston Partnership at 3; ACC at 2-4; Ameren Services Co. at 4; Weyerhaeuser Co. at 6.

[20] *See, e.g.*, Comments of CURE at 4-5; DuPont at 7; EEI at 6-7; Subscribing Coal Shippers at 16-18; ACC at 6.

[21] *See, e.g.*, Comments of USDA at 17; Dow at 14-16; PPL Generation, LLC at 12-15; ACC at 14; PPG Industries, Inc. at 2.

[22] *See, e.g.*, Comments of American Short Line and Regional R.R. Assn. ("ASLRRA") at 3; Subscribing Coal Shippers at 18-19; Ameren Services Co. at 3; PPL Generation, LLC at 15-17.

[23] In its prior comments, CPR warned that using the merger process as a platform for supplementing the competitive choices of shippers would favor those shippers who happened to be located on the lines of a carrier involved in a merger transaction, at the expense of competing shippers served by non-applicant carriers. Comments of CPR (filed May 16, 2000) at 12.

only as it pertains to merging carriers will undermine the overall goal of enhanced competition." Comments of Dow at 4. The proposed solution to this problem is for the STB to "impose concomitant access over the lines of non-merging carriers, to provide for equal competition."[24]

These proposals suffer from the same legal infirmity as the Board's reliance upon the presumption that all future consolidations would produce certain negative effects as a basis for requiring applicants to offer competition-enhancing conditions. Imposing blanket conditions upon a merger – without regard to whether the evidence shows that such conditions are necessary – would be inconsistent with both prior STB/ICC precedent and sound principles of administrative adjudication. Comments of CPR at 10-12. The proponents of these conditions fail to articulate any sound basis for using the Board's merger process to effect a wholesale restructuring of the rail industry's competitive balance.

The Board should adopt regulations under which it would seek to determine, on a case-by-case basis, the ***actual*** competitive impacts likely to result from future consolidations. The Board's primary emphasis in imposing conditions should be (as it has been) to mitigate those adverse competitive effects actually demonstrated on the record.[25] In addition, where the evidence indicates that a merger would have adverse impacts on competition or service that are not remedied by conditions or offset by other demonstrable public benefits, the regulations can

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[24] Comments of NITL at 17. *See also* comments of the Fertilizer Institute at 9-10. The STB lacks jurisdiction to impose conditions on non-applicant carriers in a merger proceeding, as suggested by NITL and Dow.

[25] USDOT agrees that the STB's regulations should attempt to ensure that competitive remedies imposed in merger cases benefit those shippers whose competitive choices would otherwise be reduced. Comments of USDOT at 4.

encourage applicants to offer, on a voluntary basis, measures to supplement the competitive choices of shippers as one possible way to satisfy the public interest balancing test. However, the Board should neither impose, nor require applicants to offer, broad-based conditions that are wholly unrelated to any actual effects of the transaction, and are otherwise not necessary to render the transaction consistent with the public interest.

IV. SERVICE ISSUES

The opening comments reflect a broad consensus among carriers and shippers alike that the STB should require future merger applicants to submit a detailed Service Assurance Plan, to establish Service Councils and informal dispute resolution procedures, and to report on the progress of merger implementation as part of the STB post-merger oversight process. The provisions of the draft regulations relating to these matters should be included in the Board's final merger rules.[26]

Certain commenters complain that the proposed regulations addressing service assurance issues lack sufficient "teeth."[27] They urge the Board to impose a variety of sanctions against applicants for post-merger service failures. The proposed remedies include mandatory

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[26] CPR's opening comments recommended certain minor modifications to those provisions. Comments of CPR at 4-6. CPR urges the Board to adopt those modifications in the final rules.

[27] *See* Comments of ACC at 13-14. *See also* Comments of American Forest & Paper Assn. at 5 ("stronger action" needed to hold merging carriers accountable); Greater Houston Partnership at 4 (STB should impose "severe sanctions" for post-merger service failures); Montana Wheat & Barley Comm. at 3 (carriers should face "economic sanctions" for service disruption).

arbitration,[28] new Board-administered complaint procedures,[29] and indemnification of shippers and shortline carriers for costs they incur as a result of merger-related service problems.[30]

CPR opposes these proposals. As an initial matter, such penalties are unprecedented. CPR is not aware of any regulated industry in which merging entities are required by law to indemnify their customers, or are otherwise punished by the regulator, for post-merger service problems. The reasons why such sanctions are not imposed by other agencies are obvious. Such penalties would deprive the merged carrier of revenue required to restore service, and could threaten the viability of a carrier already experiencing financial losses from the diversion of traffic to other carriers. Subjecting a railroad that is experiencing service problems to a wave of regulatory complaint proceedings would also divert attention from the critical task of addressing those problems.

Additional STB-sponsored remedies are not necessary to protect the public from post-merger service failures. Carriers and shippers can, and frequently do, include service guarantees and penalties in their transportation contracts today. Likewise, the *NPR Order* explicitly encourages future merger applicants to negotiate contractual service assurances – on a voluntary basis – with shippers and connecting carriers. *See NPR Order* at 20 (proposed

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[28] *See, e.g.*, Comments of The Fertilizer Institute at 8-9; USDOT at 10-11; Dow at 12-14; EEI at 11-12; National Grain & Feed Assn. at 13-14; NITL at 22; Twin Modal Corp. at 2.

[29] *See, e.g.*, Comments of BASF at 6; US Clay Producers Assn. at 3-4; Pennsylvania House Transportation Comm. at 2; National Grain & Feed Assn. at 12; EEI at 9, 11-12.

[30] *See, e.g.*, Comments of USDA at 19; BASF at 16-17; Subscribing Coal Shippers at 20-23; Montana Wheat & Barley Comm. at 2, 6; Farmrail System, Inc. at 8-9; Finger Lakes Ry. Co. at 3; NITL at 22; National Grain & Feed Assn. at 11-13; EEI at 9.

§ 1180.1(h)). The Board's existing regulations at 49 C.F.R. §§ 1146-1147 provide a mechanism under which shippers can obtain temporary alternative rail service in the event of a serious service disruption.[31] Ultimately, the marketplace will effectively sanction carriers that fail to provide adequate service, by causing shippers to shift their business to other transportation providers.

Creating additional avenues for relief would not appreciably enhance the protections available to shippers, nor would it reduce the possibility that service problems might occur in connection with future mergers. To the contrary, mandatory STB-sponsored arbitration or complaint procedures might exacerbate a post-merger service crisis by fostering an environment in which shippers choose to litigate with the affected carrier rather than working cooperatively to address the problem. The STB should adhere to the voluntary approach to service assurance embodied in the draft regulations.[32]

V. TRANSNATIONAL ISSUES

CPR's opening comments supported the Board's proposal to require applicants in cross-border merger cases to submit "full system" operating plans and competitive analyses reflecting operations both within and outside the United States.[33] However, CPR demonstrated that other provisions of proposed § 1180.1(k)(1) impose unique nationality-based evidentiary

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[31] *See* Ex Parte No. 628, *Expedited Relief for Service Inadequacies* (served December 21, 1998).

[32] USDOT likewise favors an approach to service assurance issues based upon private contractual agreements rather than mandatory regulatory processes. *See* Comments of USDOT at 9.

[33] *See NPR Order* at 21 (proposed § 1180.1(k)(1)).

burdens on "foreign" applicants that conflict with the trade policies embodied in NAFTA. Certain commenting parties have proposed a number of even more onerous special requirements for "foreign" merger applicants.

The Rail Labor Division, Transportation Trades Department of the AFL-CIO proposes an outright prohibition on any transaction that would give a foreign carrier "operational control" over U.S. rail lines.[34] It is unclear whether the prohibition sought by AFL-CIO would permit a foreign carrier to acquire corporate control of a U.S. rail carrier (but not to exercise day-to-day "operational" control), or whether the proposal amounts to an outright ban on any acquisition of a controlling interest in U.S. rail lines by Canadian (or Mexican) carriers. In either case, AFL-CIO's proposal clearly violates the terms of NAFTA, which prohibits the U.S. from imposing discriminatory requirements relating to the ***acquisition*** or ***operation*** of investments in the United States by Canadian citizens.[35]

While not endorsing outright prohibition of transnational merger transactions, USDOD expresses concern about the potential impact of foreign control of U.S. rail carriers on U.S. national defense interests. Comments of USDOD at 3-5. Among the concerns articulated by USDOD are that a transnational merger might result in the routing of military traffic over foreign lines, and that the transnational carrier's rail lines and services might not be readily available to the military in time of war. *Id.* at 4. USDOD also raises the possibility that a foreign

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[34] *See* Comments of Rail Labor Division, Transportation Trades Department, AFL-CIO ("AFL-CIO") at 14.

[35] *See* NAFTA Article 1106. *See also* NAFTA Article 102 (NAFTA intended to "increase substantially" cross-border investment opportunities).

carrier might be able to transfer its interest in the U.S. carrier to a third party without further regulatory review and approval. *Id.*

These concerns are unfounded. The ICCTA gives all shippers (including the U.S. military) the right to direct the routing of their traffic. 49 U.S.C. §10747. If USDOD were concerned about the movement of sensitive military shipments via the Canadian lines of a transnational carrier, it could simply specify that all such shipments be handled via routes located within the United States (or tender its traffic to a U.S.-owned railroad).[36] USDOD's purported concern about the "availability" in time of war of U.S. rail lines owned by a Canadian carrier is similarly misplaced. Unlike other instrumentalities of transportation such as aircraft or ships, railroad lines are not moveable assets. A transnational carrier owned by a Canadian company (like one owned by a U.S. firm) would be a "common carrier" obligated to provide service upon reasonable request. *See* 49 U.S.C. § 11101(a). USDOD's further concern that a foreign carrier controlling a U.S. railroad might subsequently be able to transfer that interest without regulatory scrutiny makes no sense. The nationality of the seller is irrelevant to the issue whether such a transaction would be subject to regulation. A sale by a foreign owner – or by a U.S. owner – would require STB approval if the prospective purchaser was a "carrier" as defined in the ICCTA. *See* 49 U.S.C. §§ 11323 *et seq.* However, a sale to a non-carrier would not be subject to prior Board approval, regardless of whether the seller was a U.S. or foreign railroad.

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[36] Access to alternative routings via Canadian lines might actually prove beneficial to the U.S. military in the event that U.S. rail lines experienced congestion during a conflict. The creation of an efficient north-south rail system serving North America would also enhance the military's ability to source materials required for the war effort from Canadian origins.

USDOD's purported misgivings about foreign ownership of U.S. rail assets are ironic in light of recent developments in the ocean shipping industry. As a result of a wave of consolidation in that industry, most of the major "U.S. flag" ocean shipping companies are now controlled, directly or indirectly, by foreign carriers.[37] Collectively, these carriers now own the vast majority of the vessels enrolled in the Maritime Security Program, which identifies a fleet of U.S.-flag ships that can be called upon to meet the needs of the U.S. military during national defense crises.[38] Yet, USDOD did not oppose those acquisitions -- indeed, it supported the acquisition of Lykes by CP Ships. Likewise, neither MARAD nor the FMC took action to prevent the control of those U.S.-flag ocean carriers by foreign entities.

Thus, agencies entrusted with regulation of the ocean carrier segment of the transportation industry have not deemed "foreign" ownership of U.S. carriers to be inherently inimical to the U.S. public interest. There is likewise no legitimate basis for the STB to suppose that the acquisition of additional U.S. rail properties by CPR (or CN) would threaten the nation's security or national defense interests. To the contrary, history suggests otherwise. Both CPR and CN have controlled U.S. rail lines for more than a century. During this period – which has seen the United States embroiled in two World Wars and several other major conflicts – no party has suggested (much less shown) that CPR's (or CN's) ownership or operation of those lines

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[37] American President Lines, the largest U.S.-flag ocean carrier, was acquired in 1997 by Neptune Orient Lines, a Singapore-based carrier in which the Government of Singapore is a major stockholder. CPR's affiliate, CP Ships, purchased the assets of the bankrupt Lykes Bros. Steamship Company in the same year. In 1999, CSX sold the ocean carrier business of SeaLand to Maersk, a Danish carrier. More recently, Farrell Lines was acquired by P&O Nedlloyd.

[38] *See* Public Law No. 104-239.

undermined the United States' defense or security interests in any way. Nevertheless, in the unlikely event that the terms of a particular cross-border rail merger were to give rise to valid national security concerns, the Exon-Florio statute already provides the means for the U.S. Government to block such a transaction.[39]

Other commenters urge the STB to impose a variety of additional requirements on "foreign" applicants. CSX suggests that the Board "refine" proposed § 1180.1(k)(1) to require a foreign applicant to address not only whether stock ownership restrictions imposed by a foreign government might affect the public interest, but also the public interest implications of "any .... ***directorship, or similar nationality or residence restrictions,"*** whether or not such restrictions are created by foreign law or by corporate action of the carriers themselves. Comments of CSX at 20-21. Article 1107 of NAFTA expressly permits both Canada and the United States to require that a majority of the board of directors of their domestic corporations be of a particular nationality.[40] Accordingly, rejecting an application by a Canadian carrier to control a U.S. railroad simply because a majority of the Canadian carrier's directors are Canadian citizens would run afoul of NAFTA.

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[39] *See* 50 U.S.C. § 2170. Under the Exon-Florio statute, the President has authority to suspend any transaction which "could result in foreign control of persons engaged in interstate commerce in the United states," if such control might threaten or impair U.S. national security.

[40] *See also* NAFTA, Vol. II, Annex I (Canada) at I-C-10 (reserving application of provisions of the Canada Business Corporations Act ("CBCA") requiring majority of directors to be Canadian citizens). The CBCA requirement that a majority of the board of directors be citizens of Canada applies to ***all*** Canadian corporations (not just railroads).

Several parties have proposed expansion of the "national favoritism" provision of draft § 1180.1(k)(1) to include an inquiry into whether a foreign railroad's commercial decisions might be detrimental to the interests of U.S. motor carriers, water carriers, shippers and ports (in addition to the U.S. rail system).[41] Certain port interests express concern that transnational mergers might create advantages for foreign ports over their U.S. competitors, and suggest that such an occurrence should be viewed as contrary to the public interest.[42] The Greater Houston Partnership recommends that the STB adopt a standard condition requiring merging railroads to maintain "strict neutrality" among ports with respect to rates, services and promotional preferences. Comments of Greater Houston Partnership at 4-5.

Such protectionism is unwarranted. The Board's longstanding policy has been to protect competition, not individual competitors.[43] To the extent that traffic shifts from one port to another as a result of better service offered by a merged carrier, such diversion should be viewed as consistent with, rather than inimical to, the public interest. The fact that a particular transaction might involve diversion from a U.S. port to a Canadian port (or vice versa) does not

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[41] *See, e.g.,* Comments of CSX at 23; Port of Seattle at 2-3; USDA at 21-22; Port Authority of New York/New Jersey at 3-4.

[42] *See, e.g.*, Comments of Port Authority of New York/New Jersey at 3; New York City Economic Development Corp. at 2-3; Port of Seattle at 3; USDOD at 7.

[43] *See* 49 C.F.R. § 1180.1(c)(2)(ii); *NPR Order* at 16 (proposed § 1180.1(d)) ("conditions are generally not appropriate to compensate parties who may be disadvantaged by increased competition"). *See also* Finance Docket No. 33388, *CSX Corp. et. al. and Norfolk Southern Corp. et al. – Control and Operating Leases/Agreements – Conrail, Inc. et al.* (served July 23, 1998) at 49 (STB concern is "preservation of competition and essential services, not the survival of particular carriers"); *CN/IC Control*, *supra* at 20 (same).

change this conclusion. The very purpose of NAFTA is to promote an efficient, integrated ***North American*** transportation system, without discrimination between Canadian and U.S. participants.[44] Any STB regulation or decision prohibiting (or penalizing) the handling of freight via the most efficient combination of North American ports and rail routes would be contrary to NAFTA's objective of ***eliminating*** barriers to the free movement of goods. The Board should reject the request of U.S. ports for protection against legitimate competition from their Canadian counterparts. Requests for similar relief by certain grain shippers should likewise be denied.[45]

The Lumber Fair Trade Group asks the STB to impose a condition on applicants in any cross-border merger that would require them to maintain full and complete business records at offices in both the United States and Canada.[46] This burdensome request is unrelated to any public interest issue within the STB's purview, and should be rejected.

In summary, there is no justification for imposing upon "foreign" rail merger applicants the additional nationality-based requirements discussed above. Nor should the STB's

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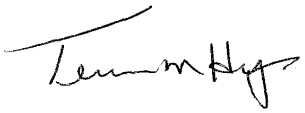
[44] *See* H.R. Rep. No. 103-361, at 8, *reprinted in* 1993 U.S.C.C.A.N. 2552, 2558 ("Benefits" of NAFTA to the U.S. include creation of "the world's largest integrated market for goods and services").

[45] *See, e.g.,* Comments of North Dakota Public Service Commission at 4-5 (asking STB to require "rate parity" for U.S. and Canadian grain shippers served by a transnational rail carrier); Comments of Montana Wheat & Barley Comm. at 4-5 (STB should take into account whether rate remedies provided for under Canadian law give Canadian shippers an advantage over their U.S. counterparts).

[46] Comments of Lumber Fair Trade Group at 1-2.

merger regulations embrace any blanket presumption that a transnational merger would be harmful to the interests of shippers, the transportation system or the national security of the United States. If credible evidence relating to unique "transnational" issues is presented in a future cross-border merger case, the Board can evaluate that evidence on a case-by-case basis, as it has done with the myriad of unique issues that have arisen in past merger cases.

Respectfully submitted,



Marcella M. Szel Q.C.
Canadian Pacific Railway Company
Suite 500, Gulf Canada Square
401 – 9th Avenue, SW
Calgary, AB T2P 4Z4
(403) 319-7000

Terence M. Hynes
Sidley & Austin
1722 Eye Street, N.W.
Washington, D.C. 20006
(202) 736-8000
(202) 736-8711 (fax)

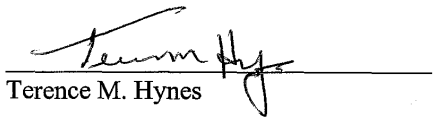
Timothy G. Mulcahy
Canadian Pacific Railway Company
Suite 1000, Soo Line Building
105 South Fifth Street
Minneapolis, MN 55402
(612) 347-8325

Counsel for Canadian Pacific Railway Company

DATED: December 18, 2000

CERTIFICATE OF SERVICE

I hereby certify that, on this 18th day of December, 2000, I served the foregoing Reply Comments of Canadian Pacific Railway Company by messenger or postage prepaid, first class mail upon all parties of record.



Terence M. Hynes